



C-AE24 STRATEGIC BUSINESS ANALYSIS MODULE 7

Ratio Analysis Part 2: Strategic Structure & Advanced Diagnostics

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Unpacking Return on Equity (ROE)

$$\text{ROE} = \text{Net Income} \div \text{Total Shareholders' Equity}$$

A headline percentage showing how efficiently capital is multiplied — but on its own, it's an *incomplete signal*.

High ROE via Operations?

Excellent pricing power and cost control

High ROE via Debt?

Reduced equity base inflates the ratio

❏ Think of ROE as a patient's temperature — it signals health or fever, but not the *cause*.



The DuPont Framework

Developed by DuPont Corporation in the early 20th century, this framework deconstructs ROE into **three independent corporate levers**.



Operating Efficiency

Net Profit Margin —
cost discipline and
pricing power



Asset Utilization

Total Asset Turnover —
how hard assets work to
generate sales



Financial Leverage

Equity Multiplier —
capital structure and
financing decisions

The Mathematical Decomposition of ROE

The DuPont identity is an elegant algebraic proof — variables cancel out, connecting the income statement directly to the balance sheet:

$$\text{ROE} = \left(\frac{\text{Net Income}}{\text{Revenues}} \right) \times \left(\frac{\text{Revenues}}{\text{Total Assets}} \right) \times \left(\frac{\text{Total Assets}}{\text{Shareholders' Equity}} \right)$$

1

Operations Team

Net Income ÷ Revenues
— pricing strategy and
cost discipline

2

Asset Managers

Revenues ÷ Total Assets
— how hard physical
assets work

3

CFO / Treasurer

Total Assets ÷ Equity —
capital structure
decisions

LEVER 1

Operating Efficiency

Net Profit Margin — how much of every peso earned trickles down to net profit after all costs, taxes, and interest.

For a restaurant conglomerate like JFC, this lever is critical. If ROE rises while margins shrink, returns are being *artificially forced* through other means — a key warning sign.

- ❏ Watch for: volatile commodity prices, rising wages, and energy costs eating into margins.



LEVER 2

Asset Utilization

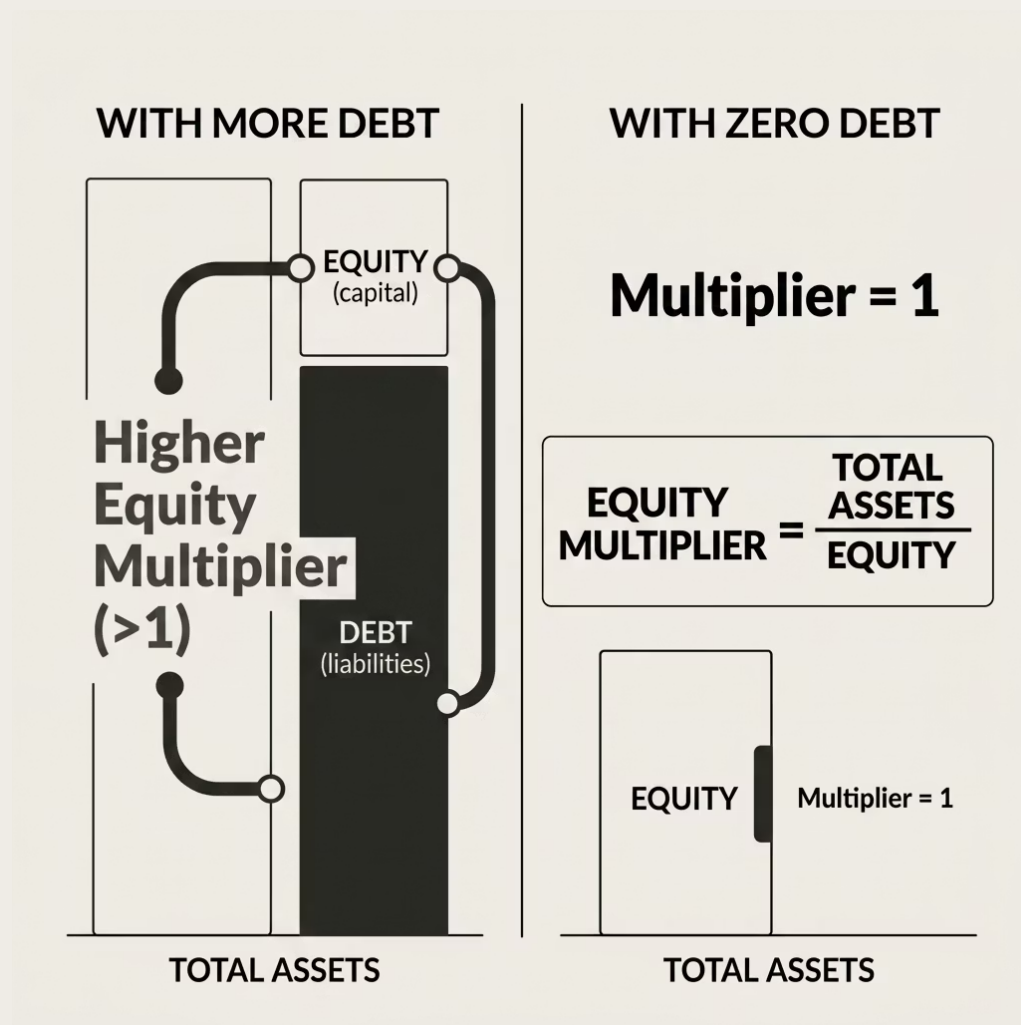
Total Asset Turnover = Revenues ÷ Average Total Assets

How many pesos of revenue does the firm generate per peso invested in assets? Aggressive store expansion spikes the asset base — if revenues don't keep pace, this lever drops.

- High turnover → stores are busy, inventory moves fast
- Low turnover → over-expansion, unproductive capital



Lever 3: Financial Leverage



LEVER 3

The Equity Multiplier

Total Assets ÷ Total Shareholders' Equity

Leverage *amplifies* returns in good years — but deepens losses in downturns. A rising Equity Multiplier without operational improvement signals structural risk, not strength.

The Interplay of the Three Levers

Different industries require different lever configurations — yet all can arrive at the same ROE. A strategic analyst must verify the lever mix matches the company's stated strategy.

Profile A — Luxury Brand

Ultra-high margins, low asset turnover. Fewer items, massive return per sale.

Profile B — Mass Market

Thin margins, high asset turnover. Success through volume and velocity.

Profile C — Leveraged Growth

High Equity Multiplier driving returns.
Operational story or financial engineering?

❏ All three profiles can show **identical 15% ROE** — only DuPont reveals the difference.

The Core Diagnostic Questions

1 Competitive Advantage?

Is profitability driven by strong operating margins — pricing power and cost discipline?

2 Asset Velocity?

Is management extracting maximum revenue from every square meter of store space?

3 Debt Dependency?

Is the business model relying heavily on risky debt to boost returns? If yes — this is a **warning sign**, not a strength.



Case Study: JFC's 2024 Context



A Global Multi-Brand Portfolio

By end of 2024, JFC managed Jollibee, Chowking, Mang Inasal, Greenwich, Smashburger, and The Coffee Bean & Tea Leaf — with aggressive international expansion funded by acquisitions and debt.

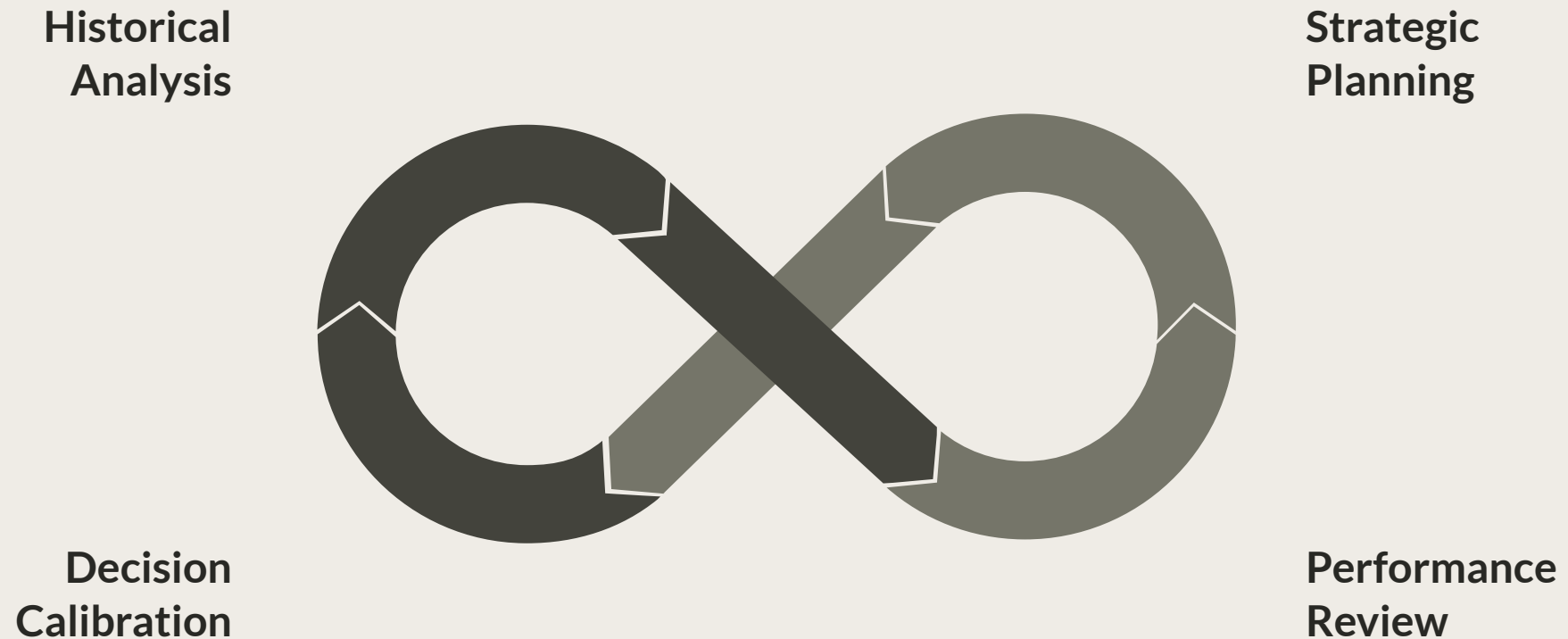
Asset Base Pressure

Heavy international build-outs expanded total assets rapidly

Elevated Multiplier

Acquisition debt kept the Equity Multiplier high

The Analyst's Responsibility: Closing the Loop



In the real world, analysis never stops at a single year. We use 2024 as our baseline, then validate against JFC's actual 2025 results — grading management's execution and refining our forward-looking assumptions.

JFC's 2025 Headline Results: A Record-Breaking Year

₱455.1B

Systemwide Sales

+16.6% year-on-year — an all-time record

₱305.1B

Consolidated Revenues

+13.0% growth for the full year

₱20.15B

Operating Income

+19.3% — growing faster than revenues

Operating income outpacing revenue growth signals a healthy **expansion in operating margins** — a strong first signal for our DuPont analysis.



Dissecting Lever 1: Operating Efficiency in 2025

Net Income to Equity Holders

₱10.87 Billion (+5.4%) — with a 30-basis-point expansion in operating income margin, confirming genuine operational improvement.

JFC balanced consumer value offerings with strict cost discipline, productivity initiatives, and optimized G&A spending.

Operating Income Growth

+19.3% — store operations became more efficient

Net Income Growth

+5.4% — slowed by elevated financing costs and higher tax provisions

□ The gap between operating and net income growth reveals the cost of carrying expansion debt.

Dissecting Lever 2: Asset Utilization in 2025

1,126

New Stores Opened

Largest single-year expansion in
JFC history

10,341

Global Outlets

Across 33 countries — 69% franchisee-
operated

The Capital-Light Franchise Shield

Opening 1,126 stores normally spikes total assets and crushes asset turnover. JFC protected this lever by shifting to a **capital-light franchising model** — ~69% of stores are franchisee-owned, expanding brand footprint without fully funding the physical assets.

Dissecting Lever 3: Financial Leverage in 2025

Strategic Trade-Off

Elevated financing costs reflect debt from major acquisitions: **Compose Coffee** and full **100% ownership of Tim Ho Wan** (effective January 2025).



The 16.6% systemwide sales growth confirms leveraged expansion is building market share — but robust, steady cash flows are essential to keep this lever safe.

- This naturally bridges us to our next pillar: **Long-Term Solvency**.

Transitioning from Liquidity to Solvency

Liquidity — The Short Game

12-month horizon. Can the firm cover immediate bills and short-term debt maturities? (Current Ratio, Quick Ratio)

Solvency — The Long Game

Decade-long survival. Is the permanent capital structure stable under economic stress? (Bonds, long-term loans, equity capital)

Our core rule: **Liquidity is about surviving tomorrow. Solvency is about thriving over the next decade.** For a global enterprise like JFC, both dimensions must be evaluated together.

Solvency Metric 1: Debt-to-Equity Ratio

The Formula

$$\frac{\text{D/E Ratio} = \text{Total Liabilities}}{\text{Total Shareholders' Equity}}$$

Measures the relative proportions of capital from **creditors vs. owners**. Who truly controls the asset base?

What It Tells Analysts

- High D/E → heavy reliance on debt financing
- Amplifies ROE in growth years
- Creates structural risk in volatile markets
- Creditors demand payment regardless of profitability

For JFC, monitoring D/E trends reveals if aggressive growth is drifting from safe financial guardrails.

Solvency Metric 2: Debt-to-Assets Ratio

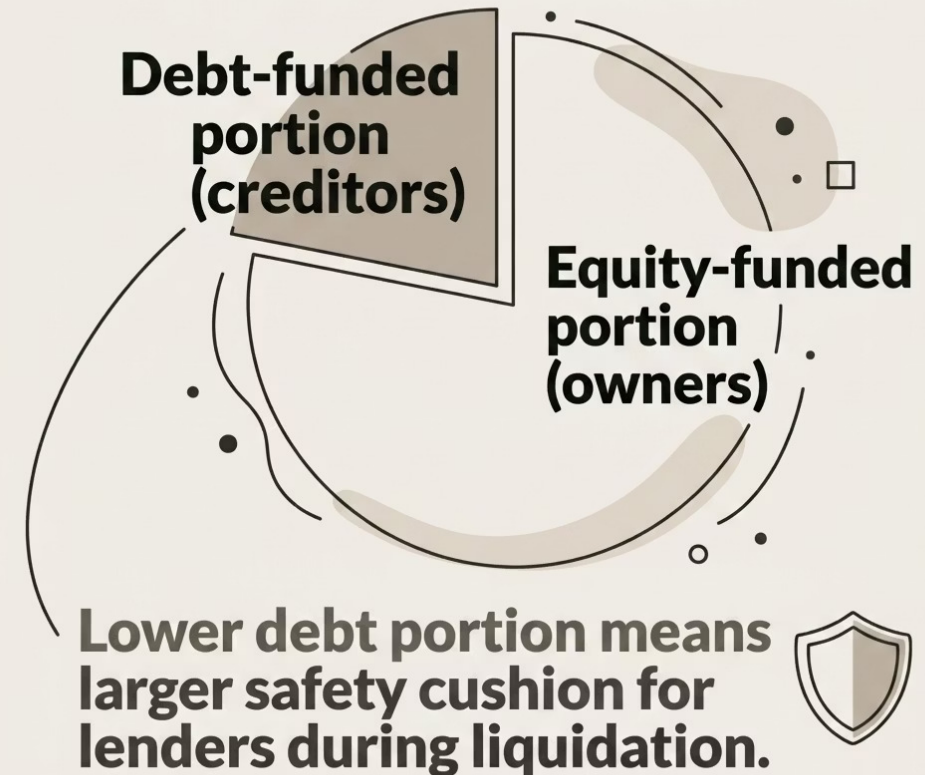
The Formula

$$\text{Debt-to-Assets} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

Shows the exact **percentage of total assets funded by creditors**. A ratio of 0.65 means 65% of all assets were debt-financed.

Highly valued by credit rating agencies — a lower ratio means a larger equity cushion to absorb losses before lenders are at risk.

Asset Funding Composition



Solvency Metric 3: Interest Coverage Ratio

The Formula

$$\text{Interest Coverage} = \frac{\text{Operating Income (EBIT)}}{\text{Interest Expense}}$$

Measures **operational capacity to service debt** from daily business profits.

- High ratio → profits cover interest many times over
- Low ratio → large portion of profits consumed by interest

Balance sheet ratios tell us how large the debt mountain is. This ratio tells us how easily operations can *climb it*.



Interest Coverage Below 1.5x: The Danger Zone

What 1.5x Means

For every ₱1.50 earned in operating profit, ₱1.00 goes straight to lenders — leaving only a ₱0.50 cushion for taxes, reinvestment, and dividends.

The Cascade Risk

Any economic shock can drop operating profits by a third, pushing coverage below 1.0x — meaning operations can no longer cover interest bills.

The Consequence

Credit downgrades, potential default, or forced corporate restructuring. A path no analyst wants to see.

Contextualizing Solvency for the Fast-Food Sector

Industry-Specific Factors

→ IFRS 16 Impact

Long-term store leases are now balance sheet liabilities — naturally inflating D/E and D/A ratios for all restaurant operators.

→ Predictable Cash Flows

Affordable meals remain in demand even during downturns — allowing QSR chains to safely carry higher debt than cyclical industries.

→ Franchise Model

Capital-light franchising transfers operational risk and asset ownership to partners, improving structural stability.

JFC's 2025 Solvency Profile in Action

Operational Cushion

JFC's all-time high **₱20.15 billion operating income** provided a strong baseline to handle elevated interest expenses from global expansion debt, lease obligations, and full acquisition of Tim Ho Wan and Compose Coffee.

"Disciplined capital allocation — deploying capex toward high-performing segments and expanding primarily through franchising." — **Richard Shin, Global CFO & CRO, JFC**

Key Lesson

Long-term debt is manageable — provided assets funded by that debt generate strong, double-digit operating income growth.

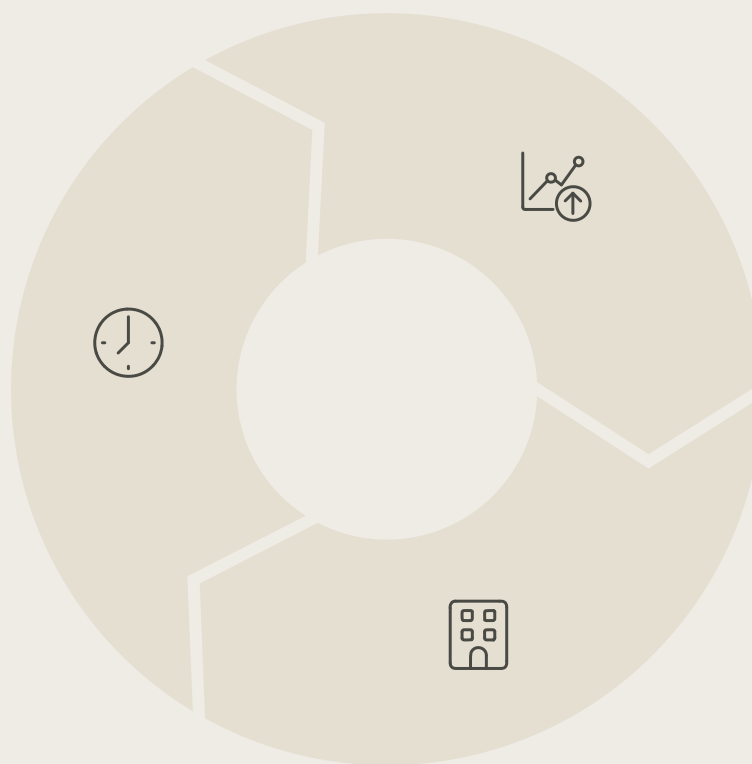
2025 Proof

+19.3% operating income growth maintained healthy solvency despite elevated financing costs.

The Holistic Diagnostic Framework

Professional analysis requires evaluating all three pillars **simultaneously** — never in isolation.

Liquidity
Short-term survival —
can the firm cover the
next 12 months?



Profitability

DuPont levers — what is truly driving returns?

Solvency

Long-term structural stability — is growth built on safe capital?

This integrated approach lets you see past corporate PR, identify hidden vulnerabilities, and reveal the **true financial condition** of any enterprise.

Key Takeaways

01

DuPont Mastery

Separate headline ROE into operating efficiency, asset utilization, and financial leverage to judge the *true quality* of profitability.

02

Three Solvency Metrics

D/E Ratio, Debt-to-Assets Ratio, and Interest Coverage Ratio — with coverage below **1.5x** as the key red flag.

03

The Continuous Loop

JFC's 2025 results validated our 2024 baseline — 1,126 new stores, ₱20.15B operating income, and capital-light franchising protecting structural health.



Your Turn: Case Study Assignment

Step into the role of a **senior strategic financial analyst**. Apply the holistic framework to JFC — and present your findings like a real board advisory.

1	2	3
Establish the Baseline Calculate DuPont levers and all three solvency ratios using JFC's 2024 financial data.	Overlay 2025 Actuals Validate against ₱305.1B revenue, ₱20.15B operating income, and ₱10.87B net income. How well did management execute?	Write the Advisory Brief 3-page forward-looking brief: Should JFC maintain aggressive global expansion into 2026, or adjust its capital structure to protect long-term solvency?

 Use your ratios to tell a clear **strategic story** — not just solve a math problem.
Happy analyzing! 